UNEQUAL BURDEN IN NEW YORK:
INCOME AND RACIAL DISPARITIES IN SUBPRIME LENDING

This study is part of a series that is constructing a national look at the growth in subprime lending[1]. Over the last decade, the amount of money available for home mortgages to borrowers with blemished or insufficient credit histories has grown at a tremendous rate. From 1993 to 1998, the number of subprime refinance loans reported under HMDA increased ten-fold – from 80,000 subprime refinance loans in 1993 to 790,000 in 1998. In 1994, the $35 billion in subprime refinance mortgages represented less than 5 percent of all mortgage refinance originations. By 1999, subprime refinance lending had increased to $160 billion, almost 13 percent of the mortgage refinance origination market.

Securitization of subprime mortgages contributed significantly to the rapid growth of the subprime mortgage market. Issuance of securities backed by subprime mortgages increased from $11 billion in 1994 to almost $83 billion in 1998, before dropping back to $60 billion in 1999. (See Figure 1.) As the primary securities underwriters, Wall Street firms have become increasingly involved in the subprime market during the last decade. In 1999, the top eight Wall Street underwriters of subprime securities accounted for three-fourths of all subprime issues. Recently, Wall Street firms have also become significant issuers of subprime securities, accounting for two of the top five issuers in 1999.

The growth in subprime lending over the last several years has been a beneficial development for borrowers with impaired or limited credit histories. Subprime lenders have allowed such borrowers to access credit that they could not otherwise obtain in the prime credit market. However, there is a growing body of anecdotal evidence that a subset of these subprime lenders, who in many cases are not subject to federal regulation, engage in abusive lending practices that strip borrowers' home equity and place them at increased risk of foreclosure. For this reason, this series of HUD reports is examining patterns in subprime lending to understand where the risk and impact of predatory practices may be highest.

AN OVERVIEW

As part of the series, this study presents a preliminary analysis of mortgage originations in the New York metropolitan area in 1998 using data reported under the Home Mortgage Disclosure Act (HMDA). This analysis covers all refinance loans originated in the New York metropolitan area, which includes the five boroughs and Westchester County. Nationwide, the HMDA data demonstrate the rapid growth of

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[1] See the HUD report Unequal Burden: Income and Racial Disparities in Subprime Lending in America, April 2000. For similar analyses of the Atlanta and Los Angeles metropolitan areas, see the HUD reports: Unequal Burden in Atlanta: Income and Racial Disparities in Subprime Lending, April 2000; and Unequal Burden in Los Angeles: Income and Racial Disparities in Subprime Lending, May 2000.

subprime refinance lending during the 1990s and the disproportionate concentration of such lending in the nation's low-income and minority neighborhoods. These same conclusions hold in the New York metropolitan area.

By providing loans to borrowers who do not meet the credit standards for borrowers in the prime market, subprime lending can and does serve a critical role in urban areas such as New York. Some borrowers may have blemishes in their credit record, insufficient credit history, or non-traditional credit sources. Thus, the subprime loan market offers these borrowers opportunities to obtain loans that they would be unable to realize in the prime loan market.

But there are two sides to this story. Since subprime lending is not subject to federal regulation, it may be a fertile ground for predatory lending activities. Anecdotal evidence suggests that these practices may include imposing and financing excessive fees, bundling high-cost loans with lump-sum credit life insurance, and requiring prepayment penalties. Predatory lending can have disastrous consequences for less financially savvy borrowers. Equity may be stripped from their homes, and in more egregious cases, they may lose their homes altogether.

Some prime lenders have made significant progress in reaching underserved communities. A recent report for the Treasury Department showed that banks and thrifts increased the share of their mortgage originations to low-income borrowers and borrowers in low-income communities from 25 percent in 1993 to 28 percent in 1998.[2] However, as the evidence in this report suggests, there are many New York neighborhoods that could benefit from increased competition from lenders in the home refinancing market. Such increased competition would give borrowers in these communities alternative options to lenders that may engage in abusive lending practices.

The first step to ensuring that subprime lending enhances the economic health of the borrowers' families without exposing them to predatory practices is to learn more about how and where it operates in America. To further understand geographic disparities, HUD has analyzed the problem nationwide and has now taken a look at the data on subprime lending in New York.[3]

THE FINDINGS FOR NEW YORK

[2] Robert E. Litan, Nicolas P. Retsinas, Eric S. Belsky, and Susan White Haag, The Community Reinvestment Act After Financial Modernization: A Baseline Report, U.S. Department of Treasury, April 2000.

[3] HUD identifies subprime loans in HMDA using a list of lenders that primarily originate subprime loans. For the list of lenders and a discussion of the methodology, see Randall M. Scheessele, 1998 HMDA Highlights, Housing Finance Working Paper No. 9, Office of Policy Development and Research, HUD, October 1999.

In general, HUD's analysis shows that subprime lending is more prevalent in lower-income and minority neighborhoods than in higher-income and white neighborhoods. This likely indicates that because of their lower incomes, lenders may consider these borrowers to be a higher credit risk, and these borrowers may therefore be less likely to qualify for prime loans. However, a lack of competition from lenders in these markets to find creditworthy borrowers may increase the chances that borrowers are exposed to the predatory practices of a subset of subprime lenders. There is also evidence suggesting that after controlling for income, black borrowers and their neighborhoods may be comparatively underserved by prime lenders.

The importance of subprime lending to minorities and low-income Americans, which is documented in what follows, demonstrates how important it is to these communities that subprime lending not include any lenders engaging in predatory practices.

1. **From 1993 to 1998, the number of subprime refinance loans originated in New York increased by about 350 percent.** The number of refinance mortgages reported under HMDA by lenders specializing in subprime lending in the New York metropolitan area increased from 3,674 loans in 1993 to 16,584 loans in 1998.

2. **Subprime loans are over three times more likely in low-income neighborhoods in New York than in upper-income neighborhoods.** In low-income neighborhoods, subprime loans accounted for 53 percent of all refinance loans originated during 1998 – compared with only 15 percent in upper-income neighborhoods.[4]

3. **Subprime loans are over four times more likely in black neighborhoods in New York than in white neighborhoods.** In predominantly black neighborhoods in New York, subprime lending accounted for 60 percent of home refinance loans originated during 1998 - compared with only 13 percent in predominantly white neighborhoods.[5]

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[4] The census tract income categories are as follows: low-income tracts have median incomes that are less than 80 percent of the metropolitan area median income (AMI); middle-income tracts, between 80 percent and 120 percent AMI, and upper-income tracts, greater than 120 percent AMI. These income categories are also used for analyses of borrower incomes relative to the area median income.

[5] This paper adopts the classification of tracts in the Woodstock Institute report, "Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development," Chicago, IL, November 1999. That is, predominantly white neighborhoods are tracts where the minority percentage is less than 15 percent; and predominantly black neighborhoods are tracts where blacks comprise at least 75 percent of the population. The racial composition of neighborhoods is based on 1990 census data; there may have been some changes in racial composition by 1998.

4. **Homeowners in upper-income black neighborhoods are over two times more likely than homeowners in middle-income white neighborhoods to refinance in the subprime market.** In 1998, 52 percent of homeowners in upper-income black neighborhoods relied upon subprime refinance loans, which was over two times the 24 percent of homeowners in middle-income white neighborhoods who have subprime loans.

5. **The findings are similar when borrowers (rather than neighborhoods) throughout the New York metropolitan area are examined. Two-thirds of low-income black borrowers in the New York metropolitan area rely upon subprime loans.** In 1998, 67 percent of the refinance loans for low-income black borrowers were subprime loans, compared with 26 percent of loans for low-income white borrowers.

THE ANALYSIS

Subprime mortgage lending provides credit to borrowers with past credit problems, often at a higher cost or less favorable terms than loans available in the conventional prime market. In most cases, these lenders offer credit to borrowers who would not qualify for a loan in the prime market, thus expanding access to credit and helping more families to own their own homes. The higher costs of these loans may serve to offset the increased risk that these lenders assume in lending to these borrowers.[6]

In some cases, however, subprime lenders engage in abusive lending practices known as "predatory lending", which hits homeowners with excessive mortgage fees, interest rates, penalties and insurance charges that raise the cost of refinancing by thousands of dollars for individual families.

HUD's study of subprime lending focuses mainly on subprime refinance lending, which accounts for nearly 80 percent of total (home purchase and refinance loans combined) subprime mortgage lending nationwide and for 76 percent of subprime lending in New York.[7] HUD's study of subprime loans in the New York metropolitan area found that:

1. **From 1993 to 1998, the number of subprime refinance loans originated in New York increased by about 350 percent.**

[6] However, there is evidence that the higher interest rates charged by subprime lenders cannot be fully explained solely as a function of the additional risks they bear. See Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency" (unpublished paper), February 25, 2000.

[7] Subprime lenders are also active in the home improvement market. Home improvement loans of subprime lenders were excluded from these comparisons.

The number of refinance mortgages reported under HMDA by lenders specializing in subprime lending in the New York metropolitan area increased from 3,674 loans in 1993 to 16,584 loans in 1998. (See Figure 2.)

The magnitude and speed of the increase in subprime lending creates a critical need for greater scrutiny. The rapid growth of subprime lending may help expand credit access for more borrowers; however, some portion of subprime lending may be occurring with borrowers whose credit would qualify them for conventional loans. Subprime lending may expose borrowers to higher up-front fees and interest rates than they would bear if they had obtained prime loans.

2. **Subprime loans are over three times more likely in low-income neighborhoods in New York than in upper-income neighborhoods.**

HUD's analysis reveals that subprime lending is being provided increasingly to low- and very low-income families and their communities. In New York, 25 percent of all refinance mortgages in 1998 were subprime, but in low-income neighborhoods, the percentage of refinances in the subprime market was over twice as large -- 53 percent. (See Figure 3). In the poorest communities, where families make 50 percent or less of the area median income, subprime refinances accounted for almost 60 percent of all refinance loans. In middle-income neighborhoods, 35 percent of refinancing families relied on a subprime loan, as did only 15 percent in upper-income neighborhoods. In 1993, only 13 percent of refinance mortgages in low-income neighborhoods and 4 percent in upper-income neighborhoods were subprime.

3. **Subprime loans are over four times more likely in black neighborhoods in New York than in white neighborhoods.**

In predominantly black neighborhoods in New York, subprime lending accounted for 60 percent of home refinance loans in 1998 - compared with only 13 percent in predominantly white areas. Thus, while subprime refinance mortgages accounted for only one in eight refinance loans originated in predominantly white neighborhoods, they accounted for three-out-of-five of the refinance loans originated in predominantly black neighborhoods. (See Figure 4.) Comparable 1993 figures were 18 percent in black neighborhoods and 4 percent in white neighborhoods.

4. **Homeowners in upper-income black neighborhoods are over two times more likely than homeowners in middle-income white neighborhoods to refinance in the subprime market.**

Notably, even after controlling for differences in neighborhood income, homeowners in black communities are more likely than homeowners in white communities to refinance in the subprime market. (See Figure 5.) Among homeowners living in the middle-income black neighborhoods, 59 percent turned to subprime lenders, compared with 24 percent of homeowners living in middle-income white neighborhoods. In fact, the subprime share (52 percent) for upper-income black neighborhoods is over twice the subprime share (24 percent) for middle-income white neighborhoods.[8]

The map of the New York metropolitan area summarizes the neighborhood concentration of subprime refinance loans. (See Figure 6.) In 1998, subprime mortgages accounted for at least 25 percent of all refinance mortgages in 1,265 (or 52 percent) of the 2,420 census tracts in the New York metropolitan area refinance market. Census tracts where Blacks comprised more than 30 percent of the population (Black neighborhoods) accounted for 598 of these 1,265 census tracts. On a market share basis, Black neighborhoods accounted for 23 percent of all refinances in the New York metropolitan area but for 49 percent of all subprime refinances.[9]

5. The findings are similar when borrowers (rather than neighborhoods) throughout the New York metropolitan area are examined. Two-thirds of low-income black borrowers in the New York metropolitan area rely upon subprime loans.

This section analyzes the New York data by individual borrowers instead of entire neighborhoods; the impacts are similar. Subprime refinances accounted for 54 percent of all refinancing by low-income borrowers throughout the New York metropolitan area; only 11 percent of upper income borrowers relied upon subprime refinancing. (See Figure 7.) The borrower data show that blacks in the New York metropolitan area are still carrying a large proportion of subprime: in 1998, 46 percent of refinance mortgages for black borrowers were subprime, compared with only 11 percent for white borrowers.

Combining data on the income and racial characteristics of the borrower shows large disparities between black and white borrowers with similar incomes. Subprime loans accounted for two-thirds (67 percent) of refinance loans originated for low-income black borrowers, compared with only 26 percent for low-income white borrowers. (See Figure 8.) Similarly, subprime loans accounted for 47 percent of refinance loans for middle-income black borrowers, compared with only 13 percent for middle-income white borrowers. In fact, upper-income black borrowers were more than twice as likely as

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[8] Figure 5 also provides comparisons for low-income, predominantly black and white neighborhoods. The data for the 15 low-income white census tracts were limited, consisting of 40 subprime loans out of a total of 239 refinance originations. Thus, the analysis here focuses on the middle-income and upper-income census tracts. However, it should be noted that two-thirds (68 percent) of the refinance loans in low-income predominantly black census tracts were subprime loans.

[9] HUD conducted other analyses based on the racial and ethnic composition of census tracts in the New York metropolitan area. In the 299 census tracts where Hispanics comprised more than 50 percent of the population, subprime loans accounted for 48 percent of all refinance loans. In the 520 tracts where African-Americans represented the majority population, subprime loans accounted for 57 percent of all refinance loans.

middle-income white borrowers to rely on the subprime market (31 percent of upper-income blacks versus 13 percent of middle-income whites); and were slightly more likely than low-income white borrowers to rely on the subprime market (31 percent for upper-income blacks versus 26 percent for low-income white borrowers).

The refinancing patterns for Hispanic borrowers can be compared to those discussed above for black and white borrowers. As shown in Figure 7, subprime loans accounted for 28 percent of refinance loans originated for Hispanic borrowers during 1998; this compares with 46 percent for black borrowers and 11 percent for white borrowers. Additional analysis is needed to understand why subprime lending has played a larger role for black borrowers than for Hispanic borrowers.

CONCLUSIONS

HUD's analysis of refinance mortgages originated in the New York metropolitan area during 1998 clearly demonstrates the exponential growth in subprime lending and its growth for lower-income and, particularly, minority homeowners and communities. As noted above, two-thirds of low-income black borrowers in the New York metropolitan area rely upon the subprime market for their refinance loans. While this growth in subprime lending has expanded access to credit for many borrowers with impaired or limited credit histories, these borrowers may also be vulnerable to predatory lending practices.

Despite the progress made by prime lenders in reaching these markets, the growth of subprime lending in both lower-income and minority communities strongly suggests that much more can be done by both primary and secondary market participants to expand access to the prime lending market.